PUBLIC EMPLOYEE PENSION REFORMS PROPOSED IN THE GOVERNOR'S FY 2005 BUDGET BILL

The Governor's FY 2005 budget includes a series of public employee pension reforms. The reforms can be broken down into three categories.

First, the budget proposes to eliminate some specific provisions that have been problematic in the past. For example, the proposals:

- eliminate the "Section 10" enhanced benefit for certain individuals who are involuntarily terminated;
- clarify that pension contributions and benefits will be based solely on salary and wages and will no longer include the value of perks, such as a housing allowance or use of an automobile;
- require buy-backs of creditable service to include a realistic interest rate to reimburse the pension system for lost interest income;
- pro-rate a retiree's pension for time spent as a member of the various employment groups, rather than being based solely on the group on the day of retirement;
- eliminate "double dipping" of both disability pensions and survivor benefits following the death of a one individual retiree; and
- eliminate the provision that gives elected officials a full year of creditable service for serving even one day in a given year.

Second, the budget proposes a way to limit instances of excessive pensions. This limit, called the "maximum retirement allowance ceiling," would be calculated separately for each employee and would vary depending on one's specific career earnings. The limit would *not* replace the existing pension calculation, which uses as factors an employee's years of service, age at retirement, and highest three years' average pay. It would instead be used as a reasonability test on the pension calculated by the standard method and would reset a pension only when triggered. The limit is designed not to be triggered for the vast majority of public employees' pensions, which have been earned through gradual pay increases over time. It is instead designed to kick in only for that small number of cases where the current system allows pensions that are excessively large in comparison to an employee's lifetime earnings.

Finally, the proposal requires that any future changes to or exceptions from the pension law that increase a pension system's unfunded liability be recognized and funded over three years, not the current 20 or more years. This is designed to maintain the integrity of pension systems statewide and thereby to secure future payments.

Frequently Asked Questions

Q: I have heard that the Governor's proposals will reduce many public employees' pensions. Is that true?

A: No. The proposals are only designed to eliminate loopholes in the current system that allow a few people to be excessively rewarded by the pension system to the disadvantage of all other retirees. The proposals are designed not affect the pensions of the vast majority of employees.

Q: Do the proposals apply to teachers and other municipal employees?

A: Yes. In general, the package of reform proposals applies to all public employees covered under public retirement systems established in Chapter 32 of the Massachusetts General Laws. That includes employees of the state, municipalities, counties, school and other districts, and various public authorities and quasi-public agencies.

Q: Do the proposals affect existing retirees' pensions?

A: No. The governor's proposals as written take effect on July 1, 2004 and would affect only people retiring on or after that date.

Q: I am currently receiving an annuity as part of my employment arrangement. How does the proposal affect me? What if I am currently receiving a housing allowance?

A: The proposal would make clear that pension contributions and the resulting benefits after June 30, 2004 would be based only on salaries and wages, including differentials for education, training, certification, and shift work. It would exclude an annuity premium or housing allowance paid by an employer from the compensation on which an employee's future pension is based.

Q: How doe pro-rating according to time spent in each employment group work?

A: Currently, the job group in which an employee is classified on the day of retirement determines his retirement benefit, even if he has spent most of his career in another group. One of the governor's reforms would average an employee's pension benefit based on time spent in each group.

For example, an employee who worked 29 years in Group 1 who then took a Group 2 job for his last year before retirement would get a pension much closer to his Group 1 benefit that his Group 2 benefit; his pension would be lower than under the current system. On the other hand, a Group 4 employee who then took a job in a lower group for a few years at the end of his career, such as an experienced firefighter who left his department to teach at the Fire Academy, would not outright lose all of his credit in the higher group but rather would get a pension closer to his Group 4 pension upon retirement.

Q: Under the proposed pension reform provisions, if I am terminated, will I get any special consideration or benefit when my pension payout is calculated?

A: No. Under the proposed reform, an employee would be treated the same whether he left voluntarily or was terminated. An employee would no longer receive an enhanced early termination retirement benefit upon termination "not for turpitude." As a result, employees would no longer have an incentive to influence their own "termination," and superiors would no longer be able to provide favored employees with windfalls that are then billed to the pension system. Other existing rights for departing employees to cash out, leave money in the system and begin drawing a pension upon reaching retirement age, or begin taking a reduced pension earlier would remain unchanged.

Q: How does the maximum retirement allowance ceiling work?

A: The proposed maximum retirement allowance ceiling (also known as the maximum pension ceiling) limits an employee's pension to an amount that is tied to the total earnings of that employee over his entire career, not just his highest three years. It is calculated based on his actual earnings history, and assumes that he made pension contributions of 15% to 20% of his earnings (depending on group) throughout his career. Those contributions are compounded at his retirement system's actuarial assumed rate of return (currently 8.25% for the state retirement system) and the resulting amount used to purchase a hypothetical annuity (also using the actuarial assumed interest rate) for the rest of his life. The annual amount of this annuity would be the employee's maximum retirement allowance ceiling. This ceiling is then compared to the amount calculated under the current system and would reset a pension only when the standard retirement allowance exceeds the ceiling.

The ceiling calculation includes a generous margin over the actual pension calculated under the current system for the average employee, and thus is designed not to affect the great majority of employees. The pension ceiling is designed to kick in if an employee's top three years' earnings were a significant increase over the trend of his average lifetime earnings. Note that the ceiling calculation does not simply substitute average pay over some longer period for the three-year period used in the current calculation.

Q: The maximum pension ceiling sounds pretty complicated. If using only the top three years' pay to calculate a pension allows abuse, why not just use the top ten years or an employee's average lifetime earnings?

A: Since an employee's top three years of pay will almost always exceed his top ten years of pay or his average lifetime pay, using either of these other averages would cut almost everyone's pension. To avoid that, the governor's proposal retains the current pension calculation, rather than changing it, but imposes a ceiling set to affect only a small number of cases.

Q: Does the maximum pension ceiling apply to all future retirements?

A: No. The maximum pension ceiling would not apply (that is, it would not even be calculated for) a few categories of pensions that work differently than most pensions. Excluded categories include:

- Disability pensions and death benefits
- Group 3 employees, whose pensions are based on time in service rather than age and whose ages at hire and retirement, promotions, and raises are strictly governed by law.
- Judges, whose retirement contributions and benefits are unique.

Q: Will the proposed maximum pension ceiling affect my annual COLA increases?

A: No. The ceiling would only be calculated and applied at the time of retirement. Subsequent COLA increases would not be affected.

Q: Then who will be affected by the ceiling?

A: The type of employee that would be affected is someone whose pension is out of line with his lifetime earnings, such as one whose three highest-earning years are at much higher pay than the rest of his employment.

For example, a local elected official who earns nominal compensation of no more than a few thousand dollars per year over a long period, then gets a full-time state job for the last three years of his career would be affected by the ceiling. Under the current system, that person, if he retires in Group 1 at 65 with 32 years of service, would receive a pension of 80% of his average pay over those three full-time years. The person at the next desk doing the same job at the same pay would receive the exact same pension if he retired at 65 but had made substantial contributions over 32 years, rather than just three. Under the governor's proposed reforms, the employee who only briefly worked full-time would receive a lower pension to reflect his lower lifetime earnings and pension contributions.

Q: I am a teacher who is currently earning $60,000 and have 30 years of service. I began my career at a salary of $11,000 and have received steady increases averaging 6% every year. Will my pension be affected? Does it matter whether I have opted for the enhanced teachers' early retirement program (Retirement Plus)?

A: No. The maximum pension ceiling is above the pension that the teacher described in the question would actually receive, with or without Retirement Plus. The governor's pension proposal is intended to affect only cases in which a retiree's benefits are grossly out of line with his contributions when compared to a typical employee. The pension cap should not affect a typical employee with steady pay increases throughout his career.

Q: Would the maximum pension ceiling affect my pension?

A: As stated above, the ceiling is designed not to affect the vast majority of employees' pensions, . A few examples of public employees and the effect, if any, of the proposed ceiling are provided below.

	Title	Age	Years of Service	Average Salary	Last Salary	Highest 3 Years Salary	Annual Pension	Maximum Pension Ceiling	Annual Reduction with Ceiling
1	Teacher (R+) 6%	55	30	$29,181	$60,000	$56,668	$32,301	$35,829	none
2	State employee 6%	55	20	$30,395	$50,000	$47,223	$14,167	$17,757	none
3	State employee 5%	65	32	$18,148	$35,000	$33,360	$26,688	$31,735	none
4	Part-time, full-time	65	30	$8,868	$66,150	$63,050	$47,288	$7,922	($38,016)
5	Police officer, jailer	63	36	$56,690*	$174,181*	$174,588*	$139,646	$125,620	($14,025)

* full years only

1. Teacher (R+) 6% - A teacher participating in Retirement Plus who received pay increases averaging 6% annually throughout his career.
2. State employee 6% - A state employee who received pay increases averaging 6% annually throughout his career. This employee retires after only 20 years of service.
3 State employee 5% - A state employee who received pay increases averaging 5% annually throughout his career and works 32 years.
4. Part-time, full-time – A local elected official who reaches annual pay of $5,000 over the first 27 years of his career, then obtains a full-time, $60,000 job for three years with 5% annual raises.
5. Police officer, jailer – A police officer who rose to the rank of lieutenant over a 36 year career, but also took a full-time job at the county jail and collected a second full-time pay for the last three years of that career. A high-profile recent example.